an idiosyncratic award." *Kircher* v. *Putnam Funds Trust*, 403 F.3d 478, 484 (7th Cir. 2005) (Easterbrook, J.), *rehearing denied*, 2005 U.S. App. LEXIS 7914 (7th Cir. May 2, 2005), *petition for cert. filed*, No. 05-409 (U.S. Sept. 29, 2005).

The text of SLUSA, its legislative purpose, and the judicial interpretation of similar language in Section 10(b) of the Securities Exchange Act of 1934 all support the conclusion that the natural meaning of SLUSA preempts state law class action holder claims. In particular, SLUSA expressly preempts *every* state law class action claim "by any private party" that is predicated upon a misstatement "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1). As this Court held in *United States* v. *O'Hagan*, 521 U.S. 642 (1997), the same language in § 10(b) requires "deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller." *Id.* at 658.

Holder class actions are necessarily dependent on two connections between an alleged deception and the purchase or sale of a covered security. First, holder class claims necessarily assert that a deception artificially inflated the prices at which a covered security held by the class was traded in the stock market. Second, holder class claims necessarily assert that a subsequent corrective disclosure of a prior deception deflated the price at which the security was traded in the stock market. These two connections between the alleged deception and stock market purchases and sales are more than sufficient to cause holder class actions to fall within SLUSA's express preemption provision.

A narrower reading of the "in connection with" language in SLUSA is not supported by *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), which created a judicial rule that a civil plaintiff pursuing the judicially-implied § 10(b) private right of action must be a purchaser or seller. This is because, as this Court held in *O'Hagan*, a year *before* SLUSA was enacted, *Blue Chip Stamps* was not based on an interpretation

of § 10(b)'s language: "We so confined the § 10(b) private right of action because of 'policy considerations.'" 521 U.S. at 664.

According the SLUSA language its broad natural meaning so that it applies to holder class actions is also essential to accomplishing SLUSA's purpose of achieving national uniformity in securities litigation. Otherwise, every securities fraud case will spawn two competing class actions: (1) A federal court class action on behalf of allegedly defrauded purchasers; and (2) a state court class action on behalf of allegedly defrauded holders.[4] Inevitably, many cases would become engulfed in conflicting substantive rulings and procedural requirements. Over time, permitting holder class action suits to proceed in state court would create an increasingly disorienting labyrinth of differing state and federal securities standards. This lack of uniformity concerning the U.S. securities markets would deter potential domestic and foreign issuers from issuing securities in U.S. markets rather than incurring the costs of being subject to both federal standards *and* 50 state standards that are always in a state of flux.

Moreover, absent preemption, the myriad statutory and common law actions available under state law inexplicably could provide a class of holder plaintiffs with a host of substantive and procedural advantages over a purchaser class's § 10(b) claim. For example, scienter is required for a purchaser to bring a §10(b) claim, but sometimes state statutory or common law claims do not require scienter. Congress views purchasers as the principal victims of securities fraud. Congress has undeniably limited purchaser

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[4] To complicate matters further, many investors would be members of both the purchaser and holder class. Any person who purchased both before and after the fraud would be a member of the holder class (for purchases before the fraud) *and* the purchaser class (for purchases after the fraud).

class actions to federal remedies, and completely preempted any state law claim on behalf of a class of purchasers. It defies logic that Congress would destroy the national uniformity sought by SLUSA in order to permit a full panoply of state law remedies to a class of holders of securities.

Such disparate treatment would be particularly inexplicable because prior to SLUSA, federal courts had established that preexisting holders of securities cannot be injured as a class by a subsequent misrepresentation. In such a circumstance, if a truthful disclosure had been made to the holder class, instead of the material misrepresentation, the stock price for the class of existing holders would immediately *decline* before preexisting holders could sell at a higher price. Or, as Judge Henry Friendly succinctly observed 34 years ago: "if the [mis]representation had not been made, the price of the stocks would not have been inflated, and there would have been no gain to be realized by a sale" by the class of holders. *Levine* v. *Seilon, Inc.*, 439 F.2d 328, 329, 333-34 (2d Cir. 1971). It therefore would be bizarre for Congress to have destroyed national uniformity by excepting holder class actions from SLUSA preemption. This Court should read SLUSA preemption consistent with its text, Congressional intent, and sound policy, and apply SLUSA to preempt state class action holder claims, just as SLUSA preempts state class action purchaser and seller claims.

ARGUMENT

I. THE NATURAL MEANING AND POLICY OF THE SLUSA PREEMPTION PROVISION REQUIRES PREEMPTION OF HOLDER CLASS ACTIONS.

A. The Text Of SLUSA Supports Preemption.

The extent of a statute's preemptive effect should be determined by the "natural meaning" of its language. *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 383-84

(1992). SLUSA preemption applies whenever "any private party" brings a class action claim that relies on a misrepresentation or omission "in connection with the purchase or sale of *a* covered security." 15 U.S.C. § 78bb(f)(1) (emphasis added).[5] Respondents improperly seek to add a requirement that the affected purchase or sale have been made "by the class members." These quoted words, however, do not appear in the SLUSA preemption provision.

Holder class actions rely on at least two connections between a misstatement and "the purchase or sale of a covered security," *id.*, regardless of whether the class members themselves purchased or sold the security in reliance upon the alleged misstatement. First, as this case illustrates, holder class actions necessarily are predicated upon a misstatement "in connection with the purchase or sale of a covered security" because they allege that a misstatement inflated the company's publicly-traded share price above its true value. See Pet. App. 6a (discussing respondents' "allegations concerning Merrill Lynch's causing certain stocks to trade at 'artificially inflated' prices through the use of deceptive devices alleged to be the 'hallmarks of stock manipulation'"); see also J.A. 53a (Am. Compl. ¶ 4) ("Throughout the Class Period the price of the ML Stocks promoted by ML were artificially inflated as a result of the manipulative efforts of ML. As a result of the efforts of ML and its agents, employees and affiliates, ML was able to, and did, manipulate the price of the ML Stocks, causing these stocks to trade at artificially inflated prices."); *accord id.* at 54a-56a, 59a-60a, 62a (Am. Compl. ¶¶ 10-16, 26, 34); *Dura*, 125 S. Ct. at 1634 (describing this type of allegation as "purchase price inflation"). Such alleged market price inflation requires that numerous purchases of securities be

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[5] SLUSA preemption does not apply to individual (*i.e.*, non-class) claims, *see* 15 U.S.C. § 78bb(f)(3)(A)(i), or to stocks that are not traded nationally. *See id.* § 78bb(f)(5)(E); *id.* § 77r(b).

made in reliance upon the alleged material misstatement. Specifically, such alleged inflation occurs only when "the *market* price of shares *traded* on well-developed markets reflects all publicly available information and, hence, any material misrepresentations." *Basic, Inc.* v. *Levinson*, 485 U.S. 224, 246 (1988) (emphases added).

Second, holder class actions necessarily rely upon an additional "connection" between a misrepresentation or omission and "the purchase or sale of a covered security." Specifically, a holder class action cannot even theoretically allege or prove injury unless disclosure of the misstatement caused a decline in the price of the stock held by the class members. Such an alleged decline exists only if a "lower price . . . reflect[s]" that actual purchases and sales were made in reaction to the corrective disclosure of "the earlier misrepresentation." *Dura*, 125 S. Ct. at 1631-32. See, *e.g.*, J.A. 53a (Am. Compl. ¶ 5: alleging "subsequent decline in the ML Stocks' values once the investigations become known"); *id.* at 53a-54a (Am. Compl. ¶ 7). Because state law holder class actions are predicated on two "connection[s] with the purchase or sale of a covered security," SLUSA expressly preempts them.

Moreover, when Congress has wanted to limit a statutory reference to civil actions brought only by securities purchasers or sellers, it has done so expressly. Thus, numerous express causes of action in the 1933 and 1934 Acts are expressly limited to civil actions brought by purchasers or sellers. See, *e.g.*, 15 U.S.C. § 77l(a) ("the person purchasing such security"); *id.* § 78r(a) ("any person . . . who . . . shall have purchased or sold"); *id.* § 78t-1(a) ("any person who . . . has purchased . . . or sold"); see also *id.* § 77k(a) ("any person acquiring"). In stark contrast, SLUSA applies to a class action claim brought by "any private party" that relies on a misstatement "in connection with the purchase or sale of a covered security." *Id.* § 78bb(f)(1). If Congress had wanted to exclude holder class actions from SLUSA preemption,

Congress would have used a term such as "any person who has purchased or sold," rather than "any private party."

B. This Court's Interpretation Of Section 10(b) In *O'Hagan* Cannot Be Squared With A Non-Preemptive Reading Of SLUSA.

United States v. *O'Hagan*, 521 U.S. 642 (1997), holds that in "indictments for violations of § 10(b) and Rule 10b-5," there is no requirement that a purchaser or seller have relied on a material misstatement or omission. *Id.* at 664-65 (citing *United States* v. *Naftalin*, 441 U.S. 768, 774 n.6 (1979)); *Holmes* v. *Securities Investor Prot. Corp.*, 503 U.S. 258, 280 (1992) (O'Connor, J., joined by White and Stevens, JJ., concurring in part and concurring in judgment) ("[T]he purchaser/seller standing requirement for private civil actions under § 10(b) and Rule 10b-5 is of no import in criminal prosecutions for willful violations of those provisions."). In particular, *O'Hagan* explained that "[t]he misappropriation theory comports with § 10(b)'s language, which requires deception 'in connection with the purchase or sale of any security,' *not* deception of an identifiable purchaser or seller." 521 U.S. at 658 (emphasis added). This means that § 10(b) can be violated "even though the person or entity defrauded is not the other party to the trade." *Id.* at 656. As described *supra*, at 8-9, a holder class action depends on two connections between the alleged deception and stock market purchases and sales, even if the holders are not parties to those trades.

Nor is there any basis to argue that *O'Hagan*'s interpretation of the "in connection with" language applied only to criminal cases, such that the exact same language somehow may have a narrower meaning in civil cases. To the contrary, because *O'Hagan* was a criminal case, the rule of lenity applied. Under the rule of lenity, *O'Hagan* could have reached its interpretation of § 10(b) only if Congress "ha[d] spoken in clear and definite *language*." *Scheidler* v. *National Org. for Women, Inc.*, 537 U.S. 393, 409 (2003) (emphasis

added). Thus, *O'Hagan* inherently ruled that in § 10(b)'s "in connection with" requirement, Congress had spoken in "clear and definite language" that proof of deception of an identifiable purchaser or seller was *not* required.[6]

Because SLUSA was enacted a year *after O'Hagan*, there is no room for respondents to argue that the similar "in connection with" language in SLUSA can be read to require that the alleged victims have been purchasers or sellers. Moreover, were this Court to adopt respondents' position, it would inevitably suggest that *O'Hagan* had misconstrued the "in connection with language," thus calling into question the elements necessary for a federal securities fraud criminal prosecution or an SEC enforcement action.

C. *Blue Chip Stamps* Was Not Based On An Interpretation Of The "In Connection With" Language.

The Second Circuit properly did not and could not say that the language of SLUSA's preemption provision itself fell short of covering a holder class action. Rather, its decision rests entirely on the premise that when SLUSA was enacted in 1998, *Blue Chip Stamps* was the existing, authoritative interpretation of similar language appearing in § 10(b). Pet. App. 27a, 29a. But, this premise is flawed because *O'Hagan* held in 1997, *before* SLUSA's enactment, that *Blue Chip*

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[6] Indeed, a dissent, as well as respondent O'Hagan and his *amici*, argued that the "principle of lenity" supported the opposite interpretation of § 10(b). *O'Hagan*, 521 U.S. at 679 (Scalia, J., concurring in part and dissenting part); *see* Brief of Respondent-Appellee, *United States* v. *O'Hagan*, 521 U.S. 642 (1997) (No. 96-842), *available at* 1997 WL 143801, at *11, *29, *33; Brief of *Amici Curiae* Law Professors and Counsel in Support of Respondent, *United States* v. *O'Hagan*, 521 U.S. 642 (1997) (No. 96-842) *available at* 1997 WL 143793, at *23-*24 & n.21; Brief of National Association of Criminal Defense Lawyers as *Amicus Curiae* in Support of Respondent, *United States* v. *O'Hagan*, 521 U.S. 642 (1997) (No. 96-842), *available at* 1997 WL 145007, at *6.

Stamps did not rest on interpreting the "in connection with" language of § 10(b).

Specifically, in *O'Hagan*, the Court, quoting *Blue Chip Stamps*, 421 U.S. at 737, held: "We so confined the §10(b) private right of action because of 'policy considerations.'" *O'Hagan*, 521 U.S. at 664. When Congress in 1998 borrowed the existing judicial interpretation of the "in connection with" language in § 10(b) when it enacted SLUSA, Congress surely borrowed *O'Hagan*, this Court's then-most recent decision. See also *Holmes*, 503 U.S. at 284 (O'Connor, J., joined by White and Stevens, JJ., concurring in part and concurring in the judgment) ("The purchaser/seller standing limitation in Rule 10b-5 damages actions thus does not stem from a construction of the phrase 'in connection with the purchase or sale of any security.'"); *id.* at 289-90 (Scalia, J., concurring in the judgment) ("[T]he limitation we approved in *Blue Chip Stamps* was essentially a legislative judgment rather than an interpretive one."). *O'Hagan* authoritatively held that *Blue Chip Stamps* was *not* a construction of § 10(b)'s language. 521 U.S. at 664-65.

O'Hagan was right. *Blue Chip Stamps* itself demonstrates that it addressed not the meaning of § 10(b)'s words, but rather the policy question of how to confine the judicially-created implied right of action for § 10(b) violations. The majority stated, "we would by no means be understood as suggesting that we are able to divine from the language of § 10(b) the express 'intent of Congress' as to the contours of a private cause of action under Rule 10b-5." 421 U.S. at 737. The Court concluded,

> we are not dealing here with any private right created by the express language of §10(b) or Rule 10b-5. *No language* in either of those provisions *speaks at all* to the contours of a private cause of action for their violation. . . . We are dealing with a private cause of action which has been judicially found to exist, and which will have to be *judicially delimited* one way or

> another unless and *until Congress addresses the question.*

Id. at 748-49 (emphases added). Because, as *O'Hagan* holds, *Blue Chip Stamps* was not based on interpreting the "in connection with" language, it provides no basis on which to constrict that language in SLUSA to less than its natural meaning.

D. SLUSA's Policy Of Achieving Uniformity In The Standards Governing U.S. Securities Litigation Supports Preemption.

As is evident from the very title of SLUSA, its purpose was to ensure "Uniform Standards" for "Securities Litigation." Thus, the Senate Report stated:

> Proponents of the legislation have argued that we live in an information age in which we have truly national, if not international, securities markets and that uniform standards are entirely consistent with Congress's preeminent power over the regulation of interstate and foreign commerce. The Committee ... found the interest in promoting efficient national markets to be the more convincing and compelling consideration in this context.

S. Rep. No. 105-182, at 4 (1998). In particular, the Senate Report stated that allowing state class action securities litigation would deter efforts to raise capital. *Id.* at 5.

In determining the scope of a statute's preemptive effect, the Court should ensure that Congress's policy choices are implemented. See, *e.g.*, *Metropolitan Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724, 746-47 (1985). Respondents' position that SLUSA permits state law holder class actions would undermine the uniform federal standards for U.S. securities class action litigation that Congress sought to achieve. As noted above, respondents' position would create both procedural morasses in specific cases, and also differing

standards governing U.S. securities litigation between the federal and state systems and among the various states. See *supra* at 6.[7]

As this Court recognized in *Blue Chip Stamps*, faced with potential securities class actions from all securities holders – not just purchasers and sellers – potential securities issuers and securities firms may conclude that "'[t]he hazards of a business conducted on these terms are [too] extreme.'" 421 U.S. at 748 (quoting *Ultramares Corp.* v. *Touche*, 174 N.E. 441, 444 (N.Y. 1931) (Cardozo, C.J.)). Indeed, this Court has recently reaffirmed that it is bad policy to permit the "'*in terrorem*'" effect produced by meritless but large class actions. *Dura*, 125 S. Ct. at 1634 (quoting *Blue Chip Stamps*, 421 U.S. at 741).

In particular, SLUSA's legislative history indicates that as foreign securities markets grow, this makes it increasingly important to ensure uniformity and certainty in the U.S. securities markets. 143 Cong. Rec. S10475, S10477 (daily ed. Oct. 7, 1997), *available at* 1997 WL 614735 ("[I]f our markets are to remain ahead of those in London, Frankfurt, Tokyo or Hong Kong, we must create uniformity and certainty."). If SLUSA is not read to preempt state holder class actions, at least some foreign companies would be deterred from issuing securities in the United States by the morass of having to litigate both state and federal class action

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[7] After SLUSA, Congress enacted the Class Action Fairness Act ("CAFA") in February 2005. CAFA's removal provision does not authorize removal of "a claim concerning a covered security." 28 U.S.C. § 1453(d)(1). The legislative history explains that "for a precipitous drop in the value of . . . stock, based on fraud" claims were already made removable and preempted by SLUSA. S. Rep. No. 109-14, at 49-50 (2005). Of course, holder class claims are claims "for a precipitous drop in the value of . . . stock." *Id.* Assuming, for the sake of argument, however, that SLUSA is not read to preempt state law holder class actions, most state law holder class actions would spring up in state courts and could not be removed.

suits under differing and inevitably changing standards. *See id.* ("How can we expect to get foreign companies to list on our exchanges if we have to explain that they will face not only our very tough Federal standards on securities fraud, but also the possibility of 50 constantly changing State standards").

II. NO POLICY RATIONALE SUPPORTS READING SLUSA NOT TO PREEMPT HOLDER CLASS ACTION STATE LAW CLAIMS.

A. The Non-Preemptive Reading Of SLUSA Would Illogically Create Greater Potential Remedies For Holders Of Securities Than For Purchasers And Sellers.

Given SLUSA's policy of ensuring uniform standards in securities litigation, the burden falls on respondents to identify some policy rationale in SLUSA that would logically support treating the preemption of holder class actions differently from purchaser class actions. There is no such rationale.

If SLUSA is not read to preempt holder class action claims, holder class members could illogically be given a better status than purchaser class members. This is because holder class members would argue that state law gives them more robust remedies and litigation tools than those available to federal class action plaintiffs who actually purchased or sold securities in reliance upon a misrepresentation or omission.

SLUSA prevents purchasers and sellers of a security from bringing class action claims based on state law even if they are pendent to their federal claims. See 15 U.S.C. § 78bb(f)(1) (preempting state law class actions claims "in any State or Federal court"); *Rieger* v. *Drabinsky* (*In re Livent, Inc. Noteholders Secs. Litig.*), 151 F. Supp. 2d 371, 385, 442-43 (S.D.N.Y. 2001) (dismissing pendent state claims for common law fraud, negligence and negligent misrepresentation by purchasers). Purchasers bringing

§ 10(b) class actions in federal court must allege and prove, *inter alia*, scienter. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 (1976). They must satisfy heightened pleading standards, see Fed. R. Civ. P. 9(b), *Ganino* v. *Citizens Utils. Co.*, 228 F.3d 154, 168 (2d Cir. 2000), and comply with an initial stay of discovery, see 15 U.S.C. § 78u-4(b)(3). If purchasers prevail, their remedies exclude punitive damages. See *id.* § 78bb(a) (judgment in excess of actual damages is impermissible under the 1934 Act); see, *e.g.*, *Pelletier* v. *Stuart-James Co.*, 863 F.2d 1550, 1557 (11th Cir. 1989) ("'Actual damages' has been interpreted to mean some form of economic loss and does not include punitive damages.").

If holders are permitted to bring state law class actions, they would argue that state law gives them a better litigation arsenal than § 10(b) purchaser plaintiffs have. States would potentially allow punitive damages,[8] the exaction of burdensome, costly discovery prior to the motion to dismiss stage, and minimal notice pleading. Holder class plaintiffs often would claim multiple state-law theories of recovery including fraud, negligent misrepresentation, and statutory remedies such as unfair and deceptive trade practices (often with treble damages). Some state claims would also be accorded a lengthier statute of limitations period.[9]

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[8] *See, e.g. Voskamp* v. *Arnoldy*, 749 S.W.2d 113, 120-21 (Tex. App. 1987) (affirming award of $3,750,000 in punitive damages when actual damages from securities fraud totaled $1,001,850).

[9] Under Sarbanes-Oxley, a § 10(b) claim must be brought no later than the earlier of two years from discovery or five years after the violation. 28 U.S.C. § 1658(b). Some state statutes of limitations appear to be longer than two years from discovery or five years from the violation. *See, e.g.*, Ind. Code Ann. § 23-2-1-19(g) (three years from discovery but not more than six years from sale); S.C. Code Ann. § 35-1-1530 (in some instances, three years from discovery or when discovery should have occurred); N.H. Rev. Stat. Ann. § 421-B:25(VII) (six years from payment to a broker-dealer or issuer); Wash. Rev. Code § 21.20.430(4)(b) (in some cases, three years from discovery).

It is incomprehensible that Congress (or anyone) would have created a system where class actions for securities holders even arguably would have more robust potential remedies and litigation tools than class actions for purchasers and sellers. Accordingly, no policy rationale supports undermining SLUSA's purpose of achieving uniform standards in securities litigation by permitting state law holder class action claims.

B. A Class Of Holders Of Securities Cannot Be Injured By A Misrepresentation.

It would be passing strange to attribute to Congress an intent to allow potentially greater remedies for holder class claims than for purchaser class claims because, prior to SLUSA, every federal court to examine a holder class claim had concluded that, as a class, holders cannot be injured by a misrepresentation or omission.[10] This was best explained in *Crocker* v. *FDIC*, 826 F. 2d. 347 (5th Cir. 1987):

> The flaw in the [holders'] argument is that it assumes a market for the stock existed at an artificially high price. This inflated price, and hence the particular market for the stock, was maintained only because of the wrongdoing of the [defendants], who concealed material financial information from the shareholders and the public that would have demonstrated the failing condition of the [company]. It follows that, had this information been released, the stock price would have immediately and precipitously fallen especially if, as is implicit in the [holders'] theory, an entire class of shareholders had simultaneously dumped their stock on the market. Thus, there would have been no market for the stock at the artificially high price. Without such a market, the [holders'] envisioned "profit opportunity" evaporates into hardly more than an illusion.

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[10] Prior to SLUSA, in federal courts, such holder class claims were usually brought in either RICO or diversity cases.

Id. at 351 (footnote omitted).

Applying *Crocker*'s analysis to our earlier hypothetical illustration, *supra*, at 4, it is clear what would have happened to the holder class if there had been no post-purchase misrepresentation concerning the business setback. Under that hypothetical, if the business setback had been promptly disclosed to the class of existing holders, D's stock price would have fallen from $50 to $30 almost instantaneously. See *Basic*, 485 U.S. at 246 n.24 The holder class simply could not have responded to disclosure of the truth by selling at the pre-disclosure artificially inflated price.

A misrepresentation merely postpones the timing of the preexisting holders' recognition of a loss from a business setback, but the misrepresentation itself does not cause any loss. For the preexisting holder class, the earlier business setback (not its concealment) causes any loss. *Accord Kagan* v. *Edison Bros. Stores, Inc.*, 907 F.2d 690, 691-92 (7th Cir. 1990); *Arent* v. *Distribution Scis., Inc.*, 975 F.2d 1370, 1374 (8th Cir. 1992) ("[A]ny injury to plaintiffs was not caused by [defendant's] failure to disclose. Plaintiffs were not harmed because they were unable to realize the true value of their stock – they were harmed because the true value of their stock was zero."); *Chanoff* v. *United States Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn. 1994), *aff'd*, 31 F.3d 66 (2d Cir. 1994) (per curiam); see also *Levine*, 439 F.2d at 329, 333-34 (Friendly, J.) (holding that even if the purchaser-seller requirement was overruled, a holder class could not prove injury, because "if the representation had not been made, the price of the stock would not have been inflated, and there would have been no gain to be realized by a sale").

The Congress that enacted SLUSA surely did not intend to permit state law securities class actions that essentially seek "a partial downside insurance policy" against business setbacks. *Dura*, 125 S. Ct. at 1634. That is exactly what holder class actions do. Rather, SLUSA's purpose of encouraging capital formation in U.S. markets by mandating

uniform federal standards for securities class actions can be achieved only if holder state law class actions are preempted.

III. SLUSA'S LEGISLATIVE HISTORY DOES NOT SUPPORT AN EXCEPTION FOR HOLDER CLASS ACTION STATE LAW CLAIMS.

Assuming, *arguendo*, that there is any reason to resort to legislative history in this case, nothing in SLUSA's legislative history refers to holder class actions. The Second Circuit nonetheless relied upon floor comments of Senator Dodd that "[t]his legislation has been carefully crafted only to affect those types of class actions that are appropriately heard on the federal level." 143 Cong. Rec. S10475, S10477 (daily ed. Oct. 7, 1997), *available at* 1997 WL 614735. Senator Dodd's statement followed a list of claims that the bill expressly did not affect. The list included "individual actions in State court . . . penny stocks, delisted securities, roll-ups . . . securities sold only within a single State . . . bad brokers . . . investment advisors . . . [and] State regulators." *Id.* State holder class actions were not included in the list and were not addressed by the Senator.

In context, Senator Dodd's comments provide no basis to find an exception in SLUSA's preemption provision for holder class actions. Senator Dodd was not even purporting to address the meaning of SLUSA's "in connection with" language. If Senator Dodd's comments are twisted to mean that preemption applies only if the claims of the class are "appropriately heard on the federal level," this would permit state law class claims *for purchasers* that could not satisfy the elements of a § 10(b) claim. For example, if a class of purchasers could not satisfy the § 10(b) requirements of scienter, loss causation, timeliness, or the like, they would argue that SLUSA did not preempt their state law claims for negligence and the like because those claims are not

"appropriately heard on the federal level."[11] Senator Dodd could not have meant this. The ambiguous comments of a single Senator that have no basis in the actual statutory language provide no ground to constrict SLUSA's natural meaning. See, *e.g.*, *Morales*, 504 U.S. at 383-85 & n.2 (holding that "natural meaning" of preemption provision of "'any . . . regulation . . . relating to rates, routes, or services'" reached state regulation of advertising even though the "legislative history contains no statements specifically addressed to state regulation of advertising").

Only by according SLUSA's preemption provision its broad natural meaning can this Court avoid destroying SLUSA's goals of achieving national uniformity and preventing vexatious securities lawsuits. SLUSA's "pre-emptive effect is not confined to knocking out state-law claims by investors who have *winning* federal claims, as plaintiffs suppose. It covers both good and bad securities claims – *especially* bad ones." *Kircher*, 403 F.3d at 484 (emphases in original). Thus, SLUSA preempts state law holder class actions.[12]

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[11] These concerns are not fanciful. As the SEC noted in its *amicus* brief in the Second Circuit supporting preemption, Pet. App. 96a & n.5, some lower courts have already used similar reasoning to hold that SLUSA permits *purchaser* state law class actions for negligence. *See Green* v. *Ameritrade, Inc.*, 120 F. Supp. 2d 795, 798-99 (D. Neb. 2000) (holding, in part, that a state law "claim [was] not preempted by SLUSA because no proof of scienter [was] required" by the state law claim), *aff'd on other grounds*, 279 F.3d 590 (8th Cir. 2002); *Burns* v. *Prudential Secs.*, 116 F. Supp. 2d 917, 924-26 (N.D. Ohio 2000) ("[P]laintiffs' allegations do not satisfy the scienter requirement for securities fraud under § 10(b) and Rule 10b-5. Because § 10(b) and Rule 10b-5 are nearly identical to the removal criteria set forth at § 78bb(f)(1) of SLUSA, it follows that removal is improper, and remand to state court is the appropriate course.").

[12] If this Court rules that holder class actions are not preempted by SLUSA, such lawsuits would give rise to constitutional questions that are not before this Court in this case. These issues include whether extraterritorial application of a state's securities laws violates the dormant

CONCLUSION

For the foregoing reasons, the judgment of the Second Circuit Court of Appeals should be reversed.

Respectfully submitted,

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commerce clause, *see Edgar* v. *MITE Corp.*, 457 U.S. 624 (1982), and constitutional limitations on essentially punitive remedies that are applied extraterritorially or where the plaintiffs were uninjured, *see State Farm Mut. Auto Ins. Co.* v. *Campbell*, 538 U.S. 408 (2003). This Court should clearly state that it is not reaching any potential federal challenges to state law holders class actions except for SLUSA preemption.

(8)

No. 04-1371

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IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

SHADI DABIT, on behalf of himself
and all others similarly situated,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
For the Second Circuit**

BRIEF OF *AMICUS CURIAE* WASHINGTON LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE

The Washington Legal Foundation (WLF) is a nonprofit, nonpartisan public interest law and policy center based in Washington, D.C., with supporters nationwide.[1] WLF engages in litigation and participates in administrative proceedings to defend free enterprise, individual rights, and a balanced civil justice system. To that end, WLF has frequently appeared as *amicus* in this Court and lower courts to address the proper scope of federal preemption. *See, e.g., Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341 (2001); *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000); *Greater N.Y. Metro. Food Council, Inc. v. Giuliani*, 195 F.3d 100 (2d Cir. 1999); *Lindsey v. Tacoma-Pierce County Health Dep't*, 195 F.3d 1065 (9th Cir. 1999); *Taylor v. SmithKline Beecham Corp.*, 658 N.W.2d 127 (Mich. 2003); *Etcheverry v. Tri-Ag Servs., Inc.*, 993 P.2d 366 (Cal. 2000).

WLF frequently publishes policy papers and takes part in litigation and agency proceedings to promote and defend legal rules that protect employees, pensioners, and investors from stock losses caused by abusive securities litigation. Among WLF's recent papers on this topic are James Maloney, *Strict Standing Requirement For Securities Fraud Suits Upheld* (2005); Lyle Roberts & Paul Chalmers, *Lower Courts Will Determine Impact Of Supreme Court's Securities Fraud Suit Ruling* (2005); and Neil M. Gorsuch & Paul B.

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[1] Pursuant to Supreme Court Rule 37.6, *amicus* states that no counsel for any party authored this brief in whole or in part, and that no person or entity, other than *amicus* and its counsel, contributed monetarily to the preparation or submission of this brief. The parties have consented to the filing of all *amicus* briefs; pursuant to Supreme Court Rule 37.3, letters evidencing this consent have been lodged with the Clerk.

Matey, *Settlements In Securities Fraud Class Actions: Improving Investor Protection* (2005).

WLF is concerned that if the decision below is not reversed, the appeals court's interpretation of the Securities Litigation Uniform Standards Act of 1998 would undermine the express preemption provision of that legislation and thereby re-open the door to vexatious securities lawsuits that Congress intended to close.

WLF has no interest, financial or otherwise, in the outcome of this lawsuit.

SUMMARY OF ARGUMENT

This case presents the question whether the Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227, 3229-30 (1998), (codified as amended in part at 15 U.S.C. §§ 77p & 78bb(f)), preempts state law class action claims based upon allegedly fraudulent statements or omissions brought solely on behalf of persons who were induced thereby to hold or retain (and not to purchase or sell) securities.

SLUSA expressly preempts any class action based upon state law concerning a material misrepresentation or omission "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1). As petitioner Merrill Lynch cogently explains, the Second Circuit erred in concluding that this provision allows suits to proceed in state court on behalf of persons who merely hold, rather than purchase or sell, securities. The identical "in connection with" statutory language in Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), has long been understood to authorize the Securities and Exchange Commission (SEC) to enforce Section 10(b)'s antifraud requirements even absent a purchase or sale of securities. To be sure, *private* actions to enforce Section 10(b) and Rule

10b-5, are limited to situations involving an actual purchase or sale of securities. As this Court has explained in *United States v. O'Hagan*, however, private actions are "so confined . . . because of 'policy considerations'" related to the potential for baseless and wasteful private litigation, not because the "in connection with" language of Section 10(b) requires any such limitation. 521 U.S. 642, 664 (1997); *see also Holmes v. Securities Investor Prot. Corp.*, 503 U.S. 258, 284 (1992) (O'Connor, J., concurring in part and concurring in the judgment) ("[t]he purchaser/seller standing limitation in Rule 10b-5 damages actions . . . does not stem from a construction of the phrase 'in connection with the purchase or sale of any security'"); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). Thus, by preempting state class actions alleging misrepresentation "in connection with the purchase or sale" of securities in SLUSA, Congress must be understood to have preempted "holder" claims as well as purchaser/seller claims. In other words, the preemptive scope of SLUSA is coextensive with the scope of the SEC's enforcement authority under Section 10(b) and Rule 10b-5, not with the more limited scope of permissible private actions to enforce those provisions.

That is also the only reading of SLUSA consistent with sound policy and common sense. As Judge Easterbrook explained, "[i]t would be more than a little strange if the Supreme Court's decision to block private litigation by non-traders became the opening by which that very litigation could be pursued under state law, despite the judgment of Congress (reflected in SLUSA) that securities class actions must proceed under federal securities law or not at all." *Kircher v. Putman Funds Trust*, 403 F.3d 478, 484 (7th Cir. 2005), *petition for cert. filed*, __ U.S.L.W. __, (U.S. Sept. 29, 2005) (No. 05-409).

As *amicus* WLF will make clear in this brief, the Second Circuit's counterintuitive reading of SLUSA cannot be justified by an appeal to federalism. Principles of federalism, and limitations on the power of the federal government, are of course the bedrock of our Constitution and of the protection of individual freedom. It is equally clear, however, that the framers intended to grant Congress power to prescribe uniform national rules when necessary to promote the flourishing of interstate commerce in our free enterprise system. This is precisely such a situation. The flow of capital manifested in the trading of securities on national exchanges is inherently interstate (indeed international) in character. Long and bitter experience teaches that the efficient operation of capital markets is placed at great risk if the law of the various States can be freely invoked to impose a multitude of different and potentially conflicting obligations.

The reality is that in SLUSA, as well as in the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (1995), which Congress passed to discourage frivolous class-action litigation, *see* H.R. Conf. Rep. No. 104-369, at 31-32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730-31, Congress worked a significant change in the relationship between federal securities law and state law.[2] While the PSLRA sought to discourage so-called strike suits by imposing more stringent pleading requirements and mandatory discovery stays, Congress enacted the SLUSA to "prevent certain State private securities class action lawsuits alleging fraud from being

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[2] Additionally, two years before SLUSA, Congress enacted the National Securities Market Improvement Act of 1996 (NSMA), Pub. L. No. 104-290, 110 Stat. 3416 (1996), which preempted some state securities regulation and divided the responsibility for securities registration and investment adviser registration between the SEC and the States.

used to frustrate the objectives of the [PSLRA]." SLUSA, § 2(5). In SLUSA, Congress thus chose to oust state law, and require that securities actions within the federal statute's coverage be brought in federal court or not at all. In so doing, Congress fundamentally altered the pre-existing relationship between federal and state securities law enforcement.

That exercise of Congressional power was entirely appropriate, and indeed at the core of the concerns that the Constitution directs our national government to address. Congress is the most efficient regulator of national securities markets because it, unlike the states, is able to establish uniform regulations that increase market efficiency and encourage the free flow of capital. That point is true regardless of whether the regulations are related to the registration of securities or the liability standards applicable in class-action suits alleging fraud. As one commentator stated, "[s]ince the problems are national, and in some respects international in scope, an effective national regulator seems more appropriate than piecemeal state regulation." Roberta S. Karmel, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe*, 28 Brook. J. Int'l L. 496, 546 (2003).

ARGUMENT

I. The Market For Securities Traded On The National Exchanges Is Inherently National And International In Character And Its Efficient Operation Is Essential For Raising And Distributing Capital.

As the Senate noted in considering SLUSA, "[w]e live in an information age in which we have truly national, if not international, securities markets." S. Rep. No. 105-182 , at 4 (1998). Congress's recent securities regulation statutes seek to reduce costs and increase efficiency by establishing uniform rules. Banking Committee Chairman Senator